

Supreme Court, U. S.  
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NO. 78-682

IN THE  
**Supreme Court of the United States**  
OCTOBER TERM, 1978

T. G. MOTORS, INC., etc.,  
*Petitioner*

v.

GAIL JACKSON, et al.,  
*Respondents*

**PETITION FOR A WRIT OF CERTIORARI TO  
THE UNITED STATES COURT OF APPEALS  
FOR THE FIFTH CIRCUIT**

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T. G. MOTORS, INC., etc.,  
*Petitioner*

v.

GAIL JACKSON, et al.,  
*Respondents*

**PETITION FOR A WRIT OF CERTIORARI TO  
THE UNITED STATES COURT OF APPEALS  
FOR THE FIFTH CIRCUIT**

Petitioner, T. G. Motors, Inc., prays that a writ of certiorari issue to review a judgment of the United States Court of Appeals for the Fifth Circuit affirming a judgment of the United States District Court for the Southern District of Texas (Houston Division). This is a companion suit to *Gray-Taylor, Inc. v. Harris County* (78-117, petition for certiorari filed July 21, 1978). Although the instant petition is complete in and of itself, the issues presented herein are the same as those in the companion case.

## OPINIONS BELOW

The United States Court of Appeals for the Fifth Circuit entered a per curiam affirmance of the District Court's Order of Dismissal. The Court of Appeals' affirmance is not reported; it is reproduced as Appendix A, *infra*, p. A-1. The District Court's Order of Dismissal is not reported; it is reproduced as Appendix B, *infra*, p. B-1.

## JURISDICTION

The judgment below was issued as mandate on August 16, 1978; it is reproduced as Appendix C, *infra*, p. C-1. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

## QUESTIONS PRESENTED

1. Whether in a suit seeking relief from alleged discriminatory implementation of local property tax plans and properly alleging jurisdiction under the Civil Rights Statutes, the Court of Appeals properly affirmed the abstention of the District Court without preliminary findings (I) that the case raised complex issues of state law which, if resolved by a federal court, would disrupt state efforts to establish a uniform policy on a matter of substantial local concern and (II) that the State provided an adequate remedy for the redress of the petitioner's federal constitutional claim?

2. Whether abstention is properly invoked to deny a federal forum with respect to a request for damages for past alleged unconstitutional plans (as opposed to a request for injunctive relief)?

## CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The Fourteenth Amendment to the Constitution of the United States of America and its implementing legislation (42 U.S.C. § 1983 and 28 U.S.C. § 1343(3)) are involved. The Tax Injunction Act, 28 U.S.C. § 1341, is also involved. Finally, Article VIII, Section 1 of the Constitution of the State of Texas and its implementing legislation (Tex. Rev. Civ. Stat. Ann. art. 7145) are involved. These provisions are set forth in Appendix D, *infra*, pp. D-1 - D-3.

## STATEMENT

The petitioner is a corporation having its principal place of business in the Spring Branch Independent School District (hereinafter referred to as the "School District") in Harris County, Texas, and is subject to the property taxes imposed by the School District. The respondents are individuals who are public officials of the School District having responsibility for the proper administration of the property taxes imposed by that jurisdiction.

The Constitution of the State of Texas (Article VIII, Section 1) and its implementing legislation (Tex. Rev. Civ. Stat. Ann. art. 7145) require that all property not expressly exempted be included on the property tax rolls and taxed. The petitioner alleged in its complaint that the respondents, acting separately and in concert, have failed to take reasonable measures to ensure compliance with this mandate, with the result that whole categories of personal property—such as corporate stock, bank and savings deposits, accounts receivable and per-

sonal automobiles—are routinely and illegally exempted from taxation by administrative inaction. As a consequence, persons owning property of the type that the respondents vigorously tax bear a higher burden of the cost of government of the School District than would be required if the respondents adopted reasonable measures to ensure that all categories of nonexempt property were taxed.

In order to protest the continuation of this illegal scheme of property taxation, the petitioner filed its property tax rendition under protest and diligently pursued all available administrative remedies without success. Failing in this effort, the petitioner filed the complaint in the instant action.

In its complaint, as amended, the petitioner sought (1) to enjoin the respondents' implementation of discriminatory property tax plans, (2) to compel, either by writ of mandamus or by mandatory injunction, the adoption by the respondents of a reasonable plan of property taxation, and (3) monetary damages for past implementation of discriminatory property tax plans. The petitioner alleged jurisdiction under the Civil Rights Statutes (42 U.S.C. § 1983 and 28 U.S.C. § 1343(3)) on the basis that the vigorous taxation of the petitioner's property, coupled with respondents' failure to adopt reasonable measures to ensure compliance with the constitutional mandate that all nonexempt property be taxed, denied to the petitioner and all persons similarly situated the Equal Protection of the Laws as guaranteed by the Fourteenth Amendment to the Constitution of the United States of America.

The District Court dismissed the action on the ground that principles of federalism and comity and the Tax Injunction Act (28 U.S.C. § 1341) denied a federal court forum for the relief sought. Upon the petitioner's appeal, the Court of Appeals affirmed without opinion pursuant to Local Rule 21 of the Fifth Circuit.

#### **REASONS FOR GRANTING THE WRIT**

1. There is no principle of federalism or comity, whether in general application or specifically applied through the Tax Injunction Act (28 U.S.C. § 1341), which supports dismissal of the petitioner's complaint. Although the per curiam affirmance by the Court of Appeals is without opinion, that Court's recent decisions in similar cases involving Harris County, Texas,<sup>1</sup> and the City of Houston, Texas,<sup>2</sup> approved abstention by the federal courts under the doctrines established in *Burford v. Sun Oil Company*, 319 U.S. 315 (1943). The District Court's opinion below did not specifically invoke *Burford*-type abstention; however, the District Court dismissed "because of the doctrines of federalism and comity, and the provisions of the Tax Injunction Act, 28 U.S.C. § 1341." (Appendix B, *infra*, p. B-1.) We respectfully submit that the Court of Appeals strayed from this Court's guidelines for the application of *Burford*, and that no principle of federalism or comity justifies abstention by the federal courts herein.

The petitioner's complaint properly pleads federal jurisdiction under the Civil Rights Statutes (42 U.S.C. § 1983

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1. *Gray-Taylor, Inc. v. Harris County*, Sup. Ct. No. 78-117, petition for certiorari filed July 21, 1978, C.A. 5 No. 77-3801, decided March 17, 1978, rehearing denied April 24, 1978.

2. *Gray-Taylor, Inc. v. Fannin*, C.A. 5 No. 77-3303, decided March 17, 1978, rehearing denied April 24, 1978.

and 28 U.S.C. § 1343(3)). The right the petitioner seeks to vindicate therefore requires the most exigent of circumstances before a federal court may properly abstain. E.g., *Moreno v. Henckel*, 431 F.2d 1299, 1301 (C.A. 5, 1970); *Wright v. McMann*, 387 F.2d 519, 525 (C.A. 2, 1967). The Court of Appeals' decision, read in concert with its decision in the companion case involving Harris County, Texas, and with the decision of the District Court below, yields the disconcerting result that discriminatory implementation of a local property tax plan is always beyond the review of the federal courts. Neither the abstention doctrines nor the Tax Injunction Act were designed to deny a federal remedy, but to relegate parties to the state courts if an adequate forum is there provided. Under any possible rule of law which would permit a federal court to dismiss an action properly alleging federal court jurisdiction, the court is required as a prerequisite to dismissal to undertake an in-depth inquiry into the adequacy of the state court remedy so as to ensure that the allegedly aggrieved party can receive a fair hearing of his complaint.

Application of the *Burford* doctrine requires more than the mere conclusion that a traditionally local issue is involved and that federal court review may require intervention in the parochial question. Specifically, *Burford* requires the presence of "complex issues of state law, resolution of which would be 'disruptive of state efforts to establish a coherent policy with respect to a matter of substantial public concern.'" *Zablocki v. Redhail*, \_\_\_\_U.S\_\_\_\_, 98 S.Ct. 673, 678 n.5 (1978). In contrast to *Burford*, this case raises no complex issue of state law or policy, but seeks instead the implementation of clearly declared state law and policy to tax all non-

exempt property uniformly. See Texas Constitution Article VIII, Section 1; Tex. Rev. Civ. Stat. Ann. art. 7145, Appendix D, *infra*, pp. D-2 - D-3. Selective enforcement of the property tax through the deliberate omission of whole categories of personal property constitutes "the rankest kind of discrimination between taxpayers." *City of Arlington v. Cannon*, 153 Tex. 566, 271 S.W.2d 414, 416 (1954). Such a plan must necessarily also violate the equal protection guaranty of the Fourteenth Amendment to the Constitution of the United States. E.g., *Garrett v. Bamford*, 538 F.2d 63 (C.A. 3, 1976), cert. denied, 429 U.S. 977 (1976); *Weissinger v. Boswell*, 330 F.Supp. 615 (M.D. Ala., 1971) (three judge court). The instant suit seeks to test the tax administrators' efforts against this standard set by clearly declared state law and hence required by the Fourteenth Amendment.

Moreover, as with the other principles of federalism that could possibly apply here (the traditional equity rule and the Tax Injunction Act), *Burford* abstention requires a specific finding that the state remedy to which the complainant is being relegated be adequate. In *Burford*, the Court was careful to find the state remedy "thorough" and "expeditious and adequate." (319 U.S. at 325 and 334). Yet, the record below is devoid of a finding of adequacy; it lacks indication that the issue of adequacy was ever considered. This is so despite the fact that the parties fully briefed the application of the Tax Injunction Act which requires a finding of adequacy of the state remedy.

This Court has repeatedly held that even uncertainty as to the adequacy of the state remedy will preclude dismissal of the federal case under the traditional equity rule and under the Tax Injunction Act, which seem to

parallel *Burford* in this respect. See *Hillsborough Township, Somerset County, N.J. v. Cromwell*, 326 U.S. 620 (1946); *Spector Motor Service v. O'Connor*, 340 U.S. 602, 605 (1951); and *Tully v. Griffin*, 429 U.S. 68, 76 (1976). Hence, the failure by the courts below to make an affirmative finding of adequacy of the state remedy casts serious doubt upon the propriety of the Court of Appeals' affirmance.

While a detailed demonstration of the inadequacy of the state remedy is beyond the scope of this petition, we think it important that the most recent in-depth, independent analyses confirm this conclusion. See Yudof, *The Property Tax in Texas under State and Federal Law*, 51 Texas L. Rev. 885 (1973); and Special Legislative Report on *Intangibles and the Property Tax* (House Study Group, Texas House of Representatives: January 23, 1978), attached as Appendix E, *infra*, pp. E-1 - E-32. Critically, the latter study concludes (*infra*, p. E-17) that, despite much litigation on the subject:

\* \* \* none of the decisions [of the Texas courts] has included a requirement that the state or a local tax district revamp its tax system to include intangibles. The result has been that intangibles theoretically must be taxed but in practice can be overlooked. Only 2% of the assessed property in the state is intangible, although as much as half of the wealth in the state is intangible property.

It is also quite significant that the stimulus for this Special Legislative Report was the danger of court intervention to correct the blatant abuse; the danger perceived, however, arose from the federal courts, not the state courts. Specifically, in *Wilson v. Brockette*, (W.D. Tex. No. A-76-CA-233), the plaintiffs complained of the allocation

of state educational funds on the basis of local property tax rolls, which in theory at least (assuming the inclusion of the rolls of all property as required by law) would have allocated state funds inversely in proportion to the ability of local jurisdictions to support education. In fact, widespread omission of whole categories of personal property (principally intangibles) resulted in the shifting of state funds from the poorer districts (which had proportionately more real property on the rolls) to wealthier districts (which had proportionately less on the rolls). As a result, the legislature's yardstick of ability to pay—the local property tax rolls—created a discriminatory allocation of state funds. In denying a request for a temporary injunction, the District Court indicated that, upon ultimate disposition of the case, it would likely hold property tax omissions violative of state and federal constitutions thereby making the school fund allocation equally deficient. (See the District Court's order in *Wilson*, reproduced as Appendix F, *infra* pp. F-1 - F-9.) The House Study Group concluded that upon final disposition of the case the federal court could require the inclusion on the rolls of the omitted property or require a new standard for allocation of school funds.

The only conceivably adequate state court remedy is the one applied in *City of Houston v. Baker*, 178 S.W. 820 (Tex. Civ. App.—Galveston 1915, writ ref'd), which involved a combination of injunction of the illegal plan and implementation post-mandamus of a legal, nondiscriminatory plan. Beyond the fact that, as Professor Yudof's extensive analysis indicates, the Texas courts have paid lip service only to the availability of this remedy, this Court suggested in *Hillsborough Township, Somerset County, N.J. v. Cromwell*, *supra*, that such a

remedy requiring the aggrieved, overtaxed taxpayer to seek the taxation of others similarly situated is not adequate as a matter of law. As this Court stated (p. 623):

The equal protection clause of the Fourteenth Amendment protects the individual from state action which selects him out for discriminatory treatment by subjecting him to taxes not imposed on others of the same class. The right is the right to equal treatment. \* \* \* The constitutional requirement, however, is not satisfied, if a State does not itself remove the discrimination but imposes on him against whom the discrimination has been directed the burden of seeking an upward revision of the taxes of other members of the class.

2. This case is not one where the petitioner seeks essentially private relief. Rather, petitioner's success would confer broad relief inuring ultimately to the benefit of the public at large through the proper implementation of the Texas property tax scheme. As is apparent from the class pled in this action, relief would beneficially affect many thousands of taxpayers now on the tax rolls and would financially affect the even greater numbers of taxpayers now avoiding the payment of taxes.

3. The dismissal by the Court of Appeals for the Fifth Circuit of the damages aspect of the instant case conflicts fundamentally with the recent decisions of the Court of Appeals for the Seventh Circuit in *Fulton Market Cold Storage Co. v. Cullerton*, (C.A. 7 No. 77-2133, decided August 7, 1978, and *Sacks Bros. Loan Co. v. Cunningham*, 578 F.2d 172 (C.A. 7, 1978).

In *Fulton Market* the Seventh Circuit considered the legislative history and policies underlying the Tax Injunction Act and held that neither the Act nor its purposes prevented an action for damages under 28 U.S.C. § 1343 and 42 U.S.C. § 1983. The *Fulton Market* conclusion had been assumed in *Sacks Bros.*, where the Seventh Circuit affirmed dismissal of a request for injunctive relief after finding an adequate state remedy, but remanded the damages aspect of the case for trial. The decisions in *Fulton Market* and *Sacks Bros.* squarely conflict with the decision in the instant case which denied the petitioner a federal court forum for its request for damages.

Petitioner herein sought injunctive relief and damages. Even if principles of federalism or the Tax Injunction Act deny a federal forum for the injunctive relief requested, abstention is appropriate only with respect to the injunctive relief and not with respect to the petitioner's prayer for damages with respect to past implementations of discriminatory tax plans. Accordingly, this Court should resolve the conflict between the circuits with respect to the availability of a federal forum for damages claims such as those presented in the instant case.

**CONCLUSION**

The petition for a writ of certiorari should be granted.

Respectfully submitted,  
*r ORIGINAL SIGNED*  
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**APPENDIX A**

IN THE  
 UNITED STATES COURT OF APPEALS  
 FOR THE FIFTH CIRCUIT

NO. 78-1340

**SUMMARY CALENDAR\***

T. G. MOTORS, INC. OF HOUSTON  
 d/b/a TOM GRAY DATSUN, ON ITS  
 OWN BEHALF AND AS A REPRESENTATIVE  
 OF A CLASS OF PERSONS SIMILARLY SITUATED,  
 Plaintiff-Appellant

v.

GAIL JACKSON, ET AL.,  
 Defendants-Appellees.

Appeal from the United States District Court  
 for the Southern District of Texas

[July 25, 1978]

Before BROWN, Chief Judge, COLEMAN and  
 VANCE, Circuit Judges.

**PER CURIAM:****AFFIRMED.** See Local Rule 21.<sup>1</sup>


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\* Rule 18, 5 Cir.; see Isbell Enterprises, Inc. v. Citizens Casualty Company of New York, Et Al., 5 Cir., 1970, 431 F.2d 409, Part I.

1. See N.L.R.B. v. Amalgamated Clothing Workers of America, 5 Cir., 1970, 430 F.2d 966.

**APPENDIX B**

IN THE  
UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF TEXAS  
HOUSTON DIVISION

CIVIL ACTION NO. H-77-1613

T. G. MOTORS, INC., OF HOUSTON, ET AL

v.

GAIL JACKSON, ET AL

**ORDER**

There came on for hearing plaintiffs' motion for temporary restraining order and defendants' motion to dismiss this case. The Court has carefully considered the complaint, the motions, and the arguments of counsel, and is of the opinion that the motion for temporary restraining order should be denied and the cause should be dismissed because of the doctrines of federalism and comity, and the provisions of the Tax Injunction Act, 28 U.S.C. § 1341. Therefore, it is hereby

ORDERED that the motion for temporary restraining order is DENIED and the case is dismissed.

DONE at Houston, Texas, this 11th day of January, 1978.

/s/ ROSS N. STERLING  
United States District Judge

**APPENDIX C**

IN THE  
UNITED STATES COURT OF APPEALS  
FOR THE FIFTH CIRCUIT

H-77-1613

NO. 78-1340

**SUMMARY CALENDAR\***

T. G. MOTORS, INC. OF HOUSTON  
d/b/a TOM GRAY DATSUN, ON ITS  
OWN BEHALF AND AS A REPRESENTATIVE  
OF A CLASS OF PERSONS SIMILARLY SITUATED,  
Plaintiff-Appellant

v.

GAIL JACKSON, ET AL.,  
Defendants-Appellees.

Appeal from the United States District Court  
for the Southern District of Texas

[July 25, 1978]

(Filed August 18, 1978)

Before BROWN, Chief Judge, COLEMAN and  
VANCE, Circuit Judges.

**PER CURIAM:**

**AFFIRMED.** See Local Rule 21.<sup>1</sup>

Costs are taxed against plaintiff-appellant.

Issued As Mandate: Aug. 16, 1978.

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\* Rule 18, 5 Cir.; see Isbell Enterprises, Inc. v. Citizens Casualty Company of New York, Et Al., 5 Cir., 1970, 431 F.2d 409, Part I.

1. See N.L.R.B. v. Amalgamated Clothing Workers of America, 5 Cir., 1970, 430 F.2d 966.

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## APPENDIX D

### CONSTITUTION OF UNITED STATES OF AMERICA

#### AMENDMENT XIV.—CITIZENSHIP; PRIVILEGES AND IMMUNITIES; DUE PROCESS; EQUAL PROTECTION; APPORTIONMENT OF REPRE- SENTATION; DISQUALIFICATION OF OFFI- CERS; PUBLIC DEBT; ENFORCEMENT

Section 1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

\* \* \*

#### 28 U.S.C.

##### § 1341. Taxes by States

The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State.

\* \* \*

##### § 1343. Civil rights and elective franchise

(3) To redress the deprivation, under color of any State law, statute, ordinance, regulation, custom or usage, of any right, privilege or immunity secured

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by the Constitution of the United States or by any Act of Congress providing for equal rights of citizens or of all persons within the jurisdiction of the United States;

\* \* \*

#### 42 U.S.C.

§ 1983. Civil action for deprivation of rights  
Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress.

\* \* \*

#### TEXAS CONSTITUTION

#### ARTICLE VIII

#### TAXATION AND REVENUE

§ 1. Equality and uniformity; tax in proportion to value; poll tax; occupation taxes; income tax; exemption of household furniture.

Section 1. Taxation shall be equal and uniform. All property in this State, whether owned by natural persons or corporations, other than municipal, shall be taxed in proportion to its value, which shall be ascertained as may be provided by law. The Legislature may impose a poll tax. It may also impose occupation taxes, both upon natural persons and upon

corporations, other than municipal, doing any business in this State. It may also tax incomes of both natural persons and corporations other than municipal, except that persons engaged in mechanical and agricultural pursuits shall never be required to pay an occupation tax; Provided, that two hundred and fifty dollars worth of household and kitchen furniture, belonging to each family in this State shall be exempt from taxation, and provided further that the occupation tax levied by any county, city or town for any year on persons or corporations pursuing any profession or business, shall not exceed one-half of the tax levied by the State for the same period on such profession or business.

\* \* \*

#### TEXAS STATUTES (Tex. Rev. Civ. Stat. Ann.)

##### Article 7145. [7503] [5061] All property taxed

All property, real, personal or mixed, except such as may be hereinafter expressly exempted, is subject to taxation, and the same shall be rendered and listed as herein prescribed. Acts 1876 p. 275; G.L. vol. 8 p. 1111.

## APPENDIX E

House Study Group      Texas House of Representatives  
Room 315-C, Capitol Building, Austin, Texas 78769

Rep. John Bryant, Chairman      (512) 475-6011

### HOUSE STUDY GROUP SPECIAL LEGISLATIVE REPORT

January 23, 1978

#### INTANGIBLES AND THE PROPERTY TAX

"All property in this state . . . shall be taxed in proportion to its value."—Article VIII, Texas Constitution.

"Personal property, for the purposes of taxation, shall be construed to include . . . all moneys, credits, bonds, and other evidences of debt owned by citizens of this State."—Article 7147 Texas Statutes

A pending federal court decision may require Texas to change its long-standing policy of failing to put intangible assets on the property tax rolls. This report examines why most intangibles are not taxed in Texas, and why some economists think they shouldn't be taxed. It also looks at how other states treat intangibles and at the arguments in favor of taxing them. Finally it considers several specific approaches Texas could choose.

This report takes its information and arguments from a variety of sources including economics journals and textbooks, state and federal government reports, and studies by lawyers, political scientists, and legislators. A list of the major sources appears at the end of the report.

/s/ JOHN BRYANT  
John Bryant, Chairman

Intangible personal property is any paper evidence of wealth. It includes money, bank deposits, stocks, bonds, annuities, pensions, mortgages, franchises, patent rights, and other similar types of assets. The Texas Constitution clearly indicates that intangibles are subject to the general property tax. However, almost no intangible property is actually on the tax rolls.

This situation may change drastically in the near future. U. S. District Judge Jack Roberts of Austin is now hearing a lawsuit (*Wilson v. Brockette*) challenging the constitutionality of the state's school finance system. The plaintiffs, rural school districts, charge that the system discriminates against them. They say that rural areas have most of their wealth in real property, almost all of which is on the tax rolls. Residents of urban and suburban districts, however, hold much of their wealth in intangible property that is not taxed. So, the plaintiffs conclude, urban and suburban districts seem to be poorer than they really are, and as a result receive more state education aid than they should be entitled to.

Last summer Judge Roberts denied a request for a preliminary injunction, but his opinion indicated that the plaintiffs are likely to win when the case is tried. He stated that "this system of distributing state funds to support public education violates the federal Equal Protection Clause." He also found that the system violates the State Constitution.

The case will probably be decided next spring. The judge could rule that intangibles must be made subject to property taxation, or that the state must find some new basis for calculating aid to local school districts. In any event, taxation of intangibles is likely to become an important public issue.

Property is commonly divided into three categories. *Real property* includes land and buildings, mineral rights, and other wealth linked closely to the land. *Tangible personal property* includes machinery, tools, business inventories, motor vehicles, home furnishings, crops, and most other movable objects. *Intangible personal property* usually refers to any evidence of wealth that is recorded on paper (or, these days, on computer tapes) such as money, securities, and bank deposits.

When the property tax was introduced, real property was the most important type because most assets consisted of land or buildings. Since the location of real property is fixed it is usually easy to find it and put it on the tax rolls. These two factors account for the fact that most wealth on the tax rolls is real property. However, real property now constitutes less than half of all wealth. This is largely due to the growth of corporations and financial institutions and the resulting proliferation of stock, bonds, and other intangible assets.

All personal property (except \$250 in household furnishings per family) is theoretically subject to the Texas property tax. However, assessors in Texas and most other states make only a limited effort to put personal property on the tax rolls. Nationwide, about 15% of all wealth is tangible personal property. Most of this, mainly motor vehicles and business inventories, winds up on the tax rolls. But virtually no intangible personal property is on the ad valorem tax rolls. Although intangibles are thought to represent almost half of the wealth in Texas, they make up only about 2% of all property that is now taxed. The exclusion of intangibles from the tax base is a major factor in the increasing burden the real property tax is putting on Texas residents.

### POTENTIAL IMPACT OF INTANGIBLES TAXATION

Estimates of the total value of intangibles in Texas vary greatly. A research project by the University of Texas—Arlington Institute of Urban Studies used several different estimating methods and came up with values of from \$125 to \$220 billion. A different study produced a figure of \$75 billion. By comparison, the Governor's Office of Education Resources study calculated that the market value of all property *now* on the tax rolls is about \$235 billion. If all intangibles were put on the tax rolls and taxed equally with real property, tax rates on real property could be reduced by 25 to 45 percent. Although taxes on intangibles are very unlikely to have such a great impact in practice, intangibles could certainly become an extremely important source of revenue.

Taxation of intangibles would make the property tax much less "regressive" since most intangibles are owned by wealthy individuals. (A "regressive" tax is one that makes people with lower incomes pay a larger percentage of their income than higher-income people must pay.) One study found that the richest 1% of the U. S. population own 77% of all corporate stock and bonds and over 90% of state and local government bonds, but only 12.5% of all real property. (Some intangibles, such as pension equities, bank deposits, and insurance reserves are much more evenly distributed.) Another study reported the percentage that intangibles constitute of the wealth of different groups in the nation:

Intangible assets as a percentage of the individual's total wealth

Individual wealth	
0 to \$15,000	42%
\$15,000 to \$30,000	30
\$30,000 to \$60,000	50
\$60,000 to \$100,000	69
\$100,000 to \$200,000	68
\$200,000 to \$500,000	89
\$500,000 to \$1,000,000	83
Over \$1,000,000	92

Well-to-do and rich individuals have most of their assets as intangibles that now escape property taxation. By contrast, a much lower percentage of the wealth of poor and middle-income people is in the form of intangibles. Most of their very limited wealth is their equity in their homes. (The poorest people of course own little wealth at all, either real or intangible.) Poor and middle-income people now pay real property taxes on their homes either directly or as a part of their rent. They would therefore benefit greatly if taxation of intangibles lowers the real property tax rate.

One interesting result of taxing intangibles would be a reduction in the total amount of federal income taxes paid by Texas residents. State and local property taxes are deductible on taxpayers' federal income tax returns. The amount saved on the federal tax depends on the income of the taxpayers involved. Higher income people are in higher tax brackets, so any new deduction saves them more in income taxes than the same deduction would save lower income taxpayers. Most intangibles are owned by people who have high incomes. Shifting some of the property tax burden onto intangibles would require these

people to pay more property taxes, and would therefore reduce their federal income tax payments. (The savings on their income taxes would counteract only part of the increased property taxes they would have to pay on their intangible assets. Their combined tax bill would rise.) The total amount of the federal tax savings would be greater than it was when only real property owners shared the property tax burden. The appendix to this report contains an example showing how this would work.

#### PROBLEMS WITH TAXATION OF INTANGIBLES

If adding intangibles to the tax base would have such a beneficial impact on local finances, if it would make the property tax less regressive, and if it is required by the Constitution, why wasn't it done long ago? There are a variety of reasons, including theoretical, administrative, and political ones.

##### *Theoretical Objections*

Theoretical objections to a tax on intangibles are based on several different lines of reasoning. The following are the most common arguments:

- Taxation of intangibles is "double taxation" of the same wealth.
- The tax would put an undue burden on investments.
- The tax is unfair because intangibles do not benefit from the services provided by the property tax.
- The tax is unfair to pensioners and others who live modestly on fixed income from intangible assets.

The "double taxation" argument relies on the idea that intangibles are not wealth but merely claims on real wealth. For example, if a building owned by a corporation is subject to the property tax it would be unfair to tax the building again by putting the corporation's stock and bonds on the tax rolls. Corporations would be taxed more heavily than unincorporated businesses and mortgaged property would be taxed twice (a tax on the property and a tax on the deed of trust) while unmortgaged property would be taxed only once.

The rebuttal to this argument is that in reality only a small portion of the value of intangibles actually "represents" assets that are already subject to the property tax. This is because most of the value of a business is not its real property but the talents of its workers and managers; its reputation, contracts, and goodwill; the patents, franchises, and other untaxed assets it owns; and the expectations investors have of the profits it will produce. In addition, corporations may own property in other states or countries where there is little or no property taxation. Further, if state and local government bonds "represent" property at all, they represent property that is exempt from the property tax. Studies of both Texas and the entire nation have estimated that only 15 to 25% of intangible wealth actually represents property that is now on the tax rolls. The rest of the value now escapes ad valorem taxation.

One compromise approach to the double taxation argument would exempt mortgages (deeds of trust) and perhaps other intangibles that also clearly represent already-taxed real property. But some advocates of taxing intangibles would reject even this approach. They

argue that double taxation is a common, and not necessarily undesirable part of our tax system. Personal income is taxed by the federal government and then much of the same money is taxed again under the state sales tax. Corporate income is taxed and then dividends are taxed. In addition, it can be argued that our economic system is based on the "creation" of new wealth from existing wealth. For example, if a person opens a bank account the bank might loan the depositor's money to a corporation that needed to build a new factory. Both the individual's bank account and the company's new factory would be actual wealth. There is little reason why one should be taxed while the other should not be. As a result, supporters of intangibles taxation suggests that the "double taxation" argument is without any merit.

The second theoretical objection to taxing intangibles is that it would put too great a burden on investments. For example, the effective property tax rate in Dallas was 2.2% in 1970. The owner of a corporate bond might be receiving a return of 8% of the bond's market value. If the property tax were applied to the bond at an effective rate of 2.2% the tax would take up over a fourth of the return on the investment. This would be so great a burden that it might cause investors to evade the tax by legal or illegal means or even to leave the state.

There are a number of rebuttals to this argument. The first is that if intangibles are taxed the tax base should expand enough to substantially reduce the tax rate. A more fundamental rebuttal considers who pays the property tax now. If tax rates are so high that intangibles taxation would put an impossible burden on investors, the current situation is clearly much worse. Real prop-

erty owners (and tenants who pay for the tax through their rent) now pay the entire tax bill. And in many cases they do not even have the advantage of owning property that provides current income that can be used to pay the tax. Taxation of intangibles could spread the burden and shift much of it to richer individuals whose higher current income would make it easier for them to afford the tax. A compromise approach suggests that intangibles should be taxed, but at a lower rate than the one applied to real property.

Another theoretical reason to oppose taxation of intangibles is that such a tax violates the principle that tax revenues should be used to benefit the sources of the tax. This argument says that since intangibles do not benefit from public services they should not be taxed to provide the services.

Supporters of intangibles taxation hold that this "principle" is seldom observed. Neither the sales tax nor the progressive income tax was designed with it in mind. And even the property tax violates the principle because it funds schools, health care, and other services that benefit people rather than property. As one author wrote, "property cannot enjoy benefits in any real sense—only people benefit. And persons who hold intangibles benefit just as much from ordered society as anyone else does."

The final theoretical argument against taxation of intangibles is that it would be very harmful to pensioners and others who live modestly on fixed income from intangible assets. The prospect of taxing widows and orphans into poverty is not a very appealing one for advocates of intangibles taxation to contemplate. A variation on this argument is that intangibles taxation is regres-

sive with respect to the least wealthy individuals in society. As the chart on page 2 indicates, the least wealthy people hold a fairly large percentage of their wealth in intangible assets. This is because these individuals own little or no real property, so intangibles make up a large percentage of their assets. They have few intangible assets, but these intangibles are all they do have. A tax on intangibles might hit them hard.

Those who support taxation of intangibles suggest that the solution to this problem would be to exempt from taxation a certain amount of intangible property owned by each person. This would be similar to the homestead exemption that is deducted from the value of real property. An exemption of the first several thousand dollars of intangible property would minimize the impact of intangibles taxation on the poor. Since most intangibles are owned by wealthy individuals, this exemption would cause a relatively small reduction in the amount of intangibles added to the tax rolls. If necessary, a higher tax rate could be applied to the remaining intangibles to compensate for the exemption.

There is an additional rebuttal to the argument that taxation of intangibles would harm the poor. As noted on page 2, poor people now pay real property taxes on their homes, either directly or as part of their rent. The savings on these taxes due to a reduction in the real property tax rate would more than make up for the new tax on intangibles in most cases.

#### *Administrative Problems*

People who oppose taxing intangible assets argue that even if we should tax them, we are in fact unable to. They point to a number of administrative difficulties:

- Problems with locating and assessing intangibles.
- The likelihood of investors moving their intangible assets to avoid taxation.
- Problems due to local administration of the property tax.
- Problems caused by multi-level ownership of the same underlying assets.

A study of intangibles taxation by the Texas Research League concluded that "discovery poses a virtually insurmountable problem."

Money and other intangible wealth can be hidden in mattresses, put in secret Swiss bank accounts, held by dummy corporations located outside the tax district, or kept out of the tax assessor's reach by many other methods both legal and illegal. The result would be discrimination against any property owners who were unable or unwilling to conceal their wealth. The revenue potential of intangibles taxation would also be drastically reduced because of these problems.

However, recent changes in federal tax policy have affected this situation so greatly that one writer now says that "to oppose an intangibles tax on the grounds that the holders of intangibles cannot be discovered is now a mistake of fact." This is because federal law now requires that every payment of over \$10 in interest, dividends, or other income from intangibles must be reported to the Internal Revenue Service by the organization that makes the payment. Since the yield on investments is very roughly proportional to the value of the intangible assets, a tax on the yield could be used as a substitute for an ad valorem property tax on intangibles. Under this ap-

proach discovery is no longer such a serious problem since the IRS has the needed information and can share it with the state government. At least four states which tax intangibles receive extensive information from the IRS about income from intangible assets owned by state residents.

The second administrative problem with taxing intangibles is that the owner may be able to move the assets around to avoid the tax. In Chicago intangibles are taxed every year according to their value on April 1. Each year at the end of March investors move hundreds of millions of dollars from taxable assets into tax-exempt U.S. bonds or out-of-state bank deposits. In addition to reducing the revenue from the tax, this problem creates serious cash shortages in local banks whose customers begin mass withdrawals each March.

One way to deal with this problem would be to assess intangibles at their average value on several days each year. This would complicate the bookkeeping, however, and would not prevent all evasion. If the tax on intangibles were based on the annual yield of the assets this problem would be eliminated, since the location of the assets at any particular moment would have no effect on the tax owed. Both the investor and the tax collector would want the investment yield to be as large as possible.

Even if the temporary shifts could be avoided a tax on intangibles could have a permanent impact on investment decisions. Investors might be tempted to move their investments into federal government securities, which federal law exempts from any state intangibles tax. If state and local government bonds were subject to the tax they would be less attractive to investors. These bonds might

have to pay higher interest rates as a result. (However, the fact that income from them is not subject to the federal income tax would help mitigate this problem.) On the other hand, investment in real property might become more desirable as real property tax rates fell. The impact of these changes on the state's economy would be hard to predict, but might be quite dramatic.

Over a longer period other changes are possible. Lower taxes on real property could stimulate a building boom. The lower taxes on agricultural land could have a strong effect on the state's farmers and ranchers. Initially, the lower taxes could improve the profitability of agriculture by reducing costs. But eventually the lower taxes might make rural land more attractive for purchase by both farmers and speculators. This could boost land values so much that taxes would rise to their original levels. Not only would this wipe out the beneficial effect of lower taxes, but the higher land values might induce some farmers to sell their land for development. Of course, farmers who wanted to sell all along would welcome the higher land values.

Still other effects could occur. The taxes on intangibles could induce wealthy individuals to leave the state or to find ways to establish residence in other states or in rural Texas tax districts with low tax rates. The tax might discourage business and individuals from moving to Texas. However, the lack of corporate or personal income taxes in Texas would help mitigate these problems.

There is little concrete information on how large a shift in economic activity the taxation of intangibles would cause. However, a University of Texas-Arlington study of several other states concluded that "a low tax

rate on most intangibles will not cause major dislocation of financial assets or industry."

Some of the difficulties mentioned above could be avoided if the intangibles tax were based on the yield from investment income. The use of annual yield would prevent most evasion problems since the location of the assets would no longer matter. The problem of permanent shifts of money into non-taxed assets would still remain, however.

Another administrative difficulty results from the local nature of the property tax. If intangibles are to be put on the local tax rolls local assessors must be able to find them. Currently the local assessors have no way to find intangible property. The state would be able to locate most intangibles through its information-sharing agreement with the Internal Revenue Service. But the terms of this agreement would probably not permit wholesale distribution of confidential federal tax information to hundreds of local assessors.

One way to deal with this problem would be to have the state gather information on ownership of intangibles and then levy a direct tax on their yield. The revenue could be distributed to local governments. Alternatively, the state could assemble information from the IRS and other sources about the ownership of intangibles by each individual in the state. Each local assessor would then be told the value of intangibles owned by each resident of his or her tax district. The intangible assets would then be made subject to the regular ad valorem tax. These and other possibilities are discussed in the last section of this report.

The final administrative problem arises when assets are controlled through several layers of ownership. Suppose several individuals own all the stock in Conglomerate A, which owns all the stock of Corporation B, which in turn owns all of Company C. If intangibles taxation applies to both corporate and individual owners of wealth, double or even triple taxation of the same assets could result. (This differs from the "double taxation" argument discussed above because in this case *all* of the value of the corporate-owned stock would be taxed two or more times.) In the example cited above the value of Company C would be taxed three times since its value would be included in the value of the stock of both Corporation B and Conglomerate A.

This problem could be avoided if the tax is applied only to intangibles owned by individuals. Under such a scheme all of Conglomerate A's stock would be taxed since all of it was owned by individuals. But none of Corporation's B stock or Company's C's stock would be taxed since it was all held by an intermediary company.

#### *Political Aspects*

Enforcement of the constitutional provision requiring taxation of intangibles would affect many different groups of Texans in different ways. Groups who would be hurt by the taxation of intangibles are sure to oppose it. This section considers how a number of groups might be affected.

Real property owners are likely to benefit if a great deal of intangible property is taxed. The more intangible wealth on the tax rolls, the lower the burden on real property.

Intangible property owners obviously have the most to lose from taxation of intangibles. And since most rich individuals have most of their wealth in intangible assets, many rich and powerful people are likely to oppose a tax on intangibles.

Residents of rural areas would probably gain from an intangibles tax. This is because, as discussed above, most wealth in rural areas is in real property now subject to the property tax. As a result rural areas receive less state education aid than they would if intangible wealth were considered.

However, enforcement of the property tax on intangibles might prompt renewed efforts to tax all *real* property. Many studies have shown that farm and ranch land is generally underassessed compared to the values put on urban and suburban real estate. Urban legislators might insist on equal taxation of agricultural property as a condition for agreeing to taxation of intangibles. The effect of both of these changes on the distribution of school aid funds is hard to predict.

Finally, local tax assessors may oppose intangibles taxation on the grounds that it would cause more work and more state interference in their work.

#### INTANGIBLES TAXATION IN TEXAS

The Texas Constitution and state statutes make it clear that intangible assets are supposed to be put on the tax rolls. The Constitution says that all property should be taxed according to its value, and statutes include money, stock, bonds, and other intangibles in the definition of property. The state Supreme Court has recognized taxation of intangibles on several occasions. For example,

it held that "we full well realize the practical difficulties and problems to be encountered in taxing bank deposits, but to hold that they are not taxable would require us to fly in the very face of the Constitution and the Statutes of this state." *Whelan v. State*, 282 S.W.2d 378 (Tex. 1955).

In this and other cases courts have thrown out taxing schemes that ignore intangibles. However, none of the decisions has included a requirement that the state or a local tax district revamp its tax system to include intangibles. The result has been that intangibles theoretically must be taxed but in practice can be overlooked. Only 2% of the assessed property in the state is intangibles, although as much as half of all wealth in the state is intangible property. Almost all of the 2% consists of bank stock and intangibles owned by utilities, both of which are made subject to taxation by separate statutes.

Articles 7165 and 7166 of VACS require local assessors to list bank stock on local tax rolls. Banks must give local assessors a list of all of their stockholders, and may not pay dividends to stockholders who are in default on their taxes. Most banks actually pay the taxes on their stock directly to the local tax assessors. Although the taxes are theoretically owed by the stockholders, it is easier for the banks to pay the taxes out of their profits than it would be for them to list all their stockholders for the assessors and then keep track of any delinquent taxes. One interesting feature of this law is that it allows the banks to deduct the assessed value of their real property from the value of their total assets. This avoids any double taxation of the real property. Even with this deduction, this tax yielded \$26 million in 1969.

Articles 7098 through 7116 of VACS set up a State Intangibles Tax Board with the authority to tax the assets of some transportation utility companies in the state. The Board is composed of the Comptroller, the Secretary of State, and the State Treasurer. Its work is done by the Intangible Tax Section of the Comptroller's Ad Valorem Tax Division. The Board assesses intangible assets of railroads, pipeline companies, and certain other transportation utilities.

The value of the intangibles is calculated indirectly. First, the company's annual income is capitalized to determine its total value. Then the value of its physical assets (land, buildings, machinery, etc.) is deducted. The remainder is the value of the company's intangibles. This amount is prorated according to the number of miles of system the company has in each tax district. The Board tells each local assessor how much property to put on the local tax rolls. The local assessor is responsible for levying and collecting the tax.

#### INTANGIBLES TAXATION IN OTHER STATES

State governments have generally chosen one of four different schemes for taxation of intangible property: treating intangibles the same as all other property, exempting them from taxation altogether, creating a special ad valorem tax system for intangibles, and taxing the yield (income) from intangibles.

Thirteen states claim to treat intangibles as part of the general property tax base. But one study says that "there is no evidence to indicate that intangible property is generally included on the tax rolls and taxed at the nominal general property tax rate" in any of these states.

The states that claim to tax intangibles equally with other property actually do not tax them at all in most cases. Texas is a member of this group of states.

Seventeen states have taken the step of formally excluding intangibles from taxation. The trend is in this direction, with eight states having repealed their tax on intangibles since 1966. This of course eliminates all of the current legal and administrative problems. However, it fails to utilize an extremely large potential source of tax revenues.

Thirteen states tax intangibles as a separate ad valorem tax system, usually at special, low rates. For example Florida taxes different types of intangibles at rates ranging from 1/10 mill to 2 mills. Even at these low rates the tax provides 4% of all state tax revenues. Kentucky has derived as much as 9% of state tax revenues from a 2.5 mill intangible tax. The rates used in other states range from 1/100 mill to 10 mills. (The impact of these rates is as follows: the owner of \$1000 of intangibles would pay an annual tax of one cent if the tax rate was 1/100 mills. At 2 mills the tax would be two dollars, and at 10 mills the tax would be ten dollars.)

To enforce this type of law, states require corporations, banks, and securities dealers to inform the state tax agency of all intangible assets owned by state residents. Most states also require individuals to report the intangibles they own to state or local tax assessors.

Nine states levy a tax on the yield from intangibles.\* For example, New Hampshire taxes income from in-

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\* The sum of the number of states using each method adds up to 52 because two states use both a yield tax and a special ad valorem tax.

tangibles at a rate of 4 $\frac{1}{4}$ %. This tax produces almost 5% of all state tax revenues. Other states tax the yield at rates ranging from 2% to 9%.

It is possible to compare these yield taxes to ad valorem tax rates. If an investment yields a return of 8%, a yield tax of 2% would be equivalent to an effective property tax rate of 0.16%, or 1.6 mills. A 9% yield tax on an investment earning 8% would be the same as an effective property tax rate of 0.72%, or 7.2 mills. By comparison, the effective real property tax today in Texas averages about 1.2%, or 12 mills.

States using special taxation schemes (either special ad valorem taxes or yield taxes) have developed a number of different rules for taxing different kinds of assets. Some states apply lower rates to mortgages than to other intangibles because of the double taxation problem discussed above. Two states tax income-producing investments on a yield basis but levy a low ad valorem tax on unproductive investments. Several states give lower tax rates to credit unions, stock of corporations located within the state, and assets used by businesses. Some states with a yield tax apply it only to dividends and interest from investments, while others apply the tax to capital gains as well.

A number of different arrangements are used to administer intangibles taxes. These range from centralized assessment and collection done by a state agency to reliance on local assessors to find and tax intangibles. Most states use systems where a state agency at least helps to locate intangibles.

Kentucky uses a combined state/local system. All owners of intangibles must file an annual report with the

County Tax Commission listing the intangibles owned and stating their value. The Tax Commission then taxes the intangibles at special rates and collects the taxes along with the regular property tax.

To prevent evasion, the State Department of Revenue collects information about intangibles ownership. All banks, corporations, life insurance companies, and stockbrokers in the state must report to the Department the intangibles owned by state residents. Internal Revenue Service information is used to check the data and to find out about ownership of out-of-state intangible assets. The Department then forwards this information to the County Tax Commissions.

The state of North Carolina uses a more centralized approach. The state's Department of Revenue receives reports from corporations, banks and other institutions on the amount of intangibles owned by state residents. All owners of intangibles must file an annual return with the Department and must pay any tax that is due. The Department compares returns with the information received from corporations and banks to prevent any tax evasion. The Department collects all the funds, which it then distributes among counties and municipalities. The total cost of administration is about 2.5% of the revenues that are collected.

In Texas, administration of an expanded intangibles tax could be carried out by the existing State Intangibles Tax Board. Legislation would be needed to require corporations, banks, and other "issuers" of intangibles to report to the Board on intangibles owned by state residents. The Board would make arrangements with the Internal Revenue Service to use IRS information to check

on the accuracy of individuals' tax returns. The assessment rolls could be maintained either at the state or local level once the Intangibles Board has located the assets. Levying and collecting the taxes could also be done at either level.

Several states have overcome the traditional obstacles to taxing intangibles and have realized substantial tax revenues from them. While these states still tax intangibles at a lower effective rate than they apply to real property, these programs do help ease the burden on real property.

#### ALTERNATIVE APPROACHES FOR TEXAS

The current Texas policy towards intangibles is in open violation of the State Constitution and state laws. It is a standing invitation to lawsuits, and it allows a huge source of potential revenue to escape taxation. There are four main alternatives to the current situation:

1. Exempt intangibles from taxation.
2. Take steps to apply the regular ad valorem property tax to intangibles.
3. Put intangibles under a special ad valorem property tax.
4. Levy a tax on the yield from intangibles.

##### *1. Exempt intangibles from taxation*

This could be done by amending Article VIII, Section 1 of the Constitution to delete or modify the requirement that intangible property be taxed. (Senators Ray Farabee and Grant Jones introduced a proposed Constitutional Amendment (SJR 1) during the 1977 Special Session

that would have exempted intangibles from the property tax. It was never brought to a vote.) The amendment could exempt all intangibles from the property tax. Or, it could be written so that the existing tax on bank stock and intangibles owned by utilities could continue, while exempting all other intangibles. Banks and utility companies would undoubtedly work hard to include their intangibles in the exemption.

This approach would be the simplest since it merely legalizes the status quo, or changes it slightly by removing the tax on bank and utility intangibles. However, it would be the least beneficial for the state's property taxpayers. First, a very large potential source of state revenue would continue to be ignored. Also, unless the amendment continued the tax on bank stock and utility intangibles tax revenues would fall since the fifty to seventy-five million dollars in existing annual tax collections from these sources would be lost.

##### *2. Take steps to apply the regular ad valorem property tax to intangibles*

The legislature could simply instruct local assessors to begin putting intangibles on the tax rolls. However, assessors would probably have a very difficult time locating intangible assets. Jurisdictional problems might also develop regarding where intangibles should be taxed. Evasion of the tax would be very easy. Few intangibles would be likely to actually wind up on the tax rolls. Measures could be taken to aid the assessors in locating intangibles. Individuals could be required to report the intangibles they own to the assessor of the county in which they live. This procedure is now used in Kentucky. This system

still relies on self-reporting of assets, and evasion is still possible.

Kentucky and other states attack this problem by empowering a state agency to locate and assess intangibles. In Texas, the role of the State Intangibles Tax Board could be expanded to give it the power to collect information about all intangibles owned by state residents. Banks, corporations, and other financial institutions could be required to inform the Board about ownership of intangibles by state residents. The Board could use Internal Revenue Service data to verify its records. The Board would calculate the amount of intangible assets owned by each state resident, and would forward the information to local assessors. The assessors would then put the assets on the tax rolls and collect the taxes.

The advantage of this approach is that it would produce large amounts of revenue from property owners who could generally afford to pay the taxes. It would allow state government agencies to help locate intangibles but it would permit the continued use of local tax levies and collection. It would not require a constitutional change.

The disadvantages of this system are that it adds still more complexity to the property tax system. Statewide determination of the value of all intangible property might be a very difficult task. The question of how to allocate assets among the state's hundreds of tax districts is sure to be a controversial one. The system would not allow use of an exemption for small amounts of intangibles owned by poor individuals. And the plan is likely to be opposed both by local assessors who resent any state in-

terference in their work and by wealthy individuals who would rather not have their assets taxed.

*3. Put intangibles under a special ad valorem property tax*

It might be desirable to tax intangibles at lower rates than those applied to real property. Or, different types of intangibles could be taxed at different rates. For example, some states tax mortgages and pension assets at very low rates. Finally, many advocates of taxing intangibles favor exempting the first several thousand dollars of assets owned by each individual to protect poor people from the tax.

A constitutional amendment would be needed to authorize any programs of this nature, since the Constitution now requires all property to be taxed uniformly. Once the Constitution was amended the tax rates on different classes of intangibles could be set by the legislature. (Some state legislatures set maximum rates for different types of intangibles, leaving it up to local tax districts to decide the actual tax rate they want to use.)

Under this special ad valorem tax plan, the State Intangibles Tax Board could be used to locate intangibles as in the alternative discussed above. Collection of the taxes could be done either by the state or by local assessors.

The main advantage of this plan is that it would give the legislature a great deal of flexibility in designing the intangibles tax. A resulting disadvantage is that it would permit the creation of loopholes that might weaken the effect of the tax. Also, the constitutional amendment needed to authorize the tax might not be popular with the voters.

*4. Levy a tax on the yield from intangibles*

This would be quite similar to the previous approach. However, the yield tax would avoid some of the problems involved in ad valorem taxation of intangibles. Since only yield would be considered, there would be no need to determine the value of all intangibles. And information on yield is obtainable from the Internal Revenue Service and from the corporations, banks, and other organizations that make the payments.

A number of variations on this approach are possible. The tax could be levied and collected by the state or the job could be done at the local level once the state determined the amount of taxable yield for each taxpayer. The revenue from a state-collected tax could be put in the General Fund or it could be distributed to local tax districts.

The advantage of the yield tax is that it would be the simplest to administer while still producing a great deal of revenue. It would be the best tax from an "ability-to-pay" viewpoint since it would tax only assets that are currently producing income.

However, there would probably be disputes over who should levy and collect the tax and how the revenues from it should be distributed. And it might be opposed as setting a precedent for increased state government participation in the administration of the local property tax. Finally, the Texas Constitution now specifies that property must be taxed in proportion to its value. In many cases, such as securities that appreciate in value but produce no dividends or other current yield, the annual yield from intangible assets is not at all proportion-

al to their value. As a result, a yield tax could not be used to satisfy the constitutional requirement that intangibles be subject to the ad valorem property tax.

If the Legislature found it desirable to use a yield tax in place of an ad valorem tax on intangibles, several actions would be needed. A constitutional amendment would be required to remove intangibles from the ad valorem tax. The yield tax could be instituted either by statute or by constitutional amendment. The existing constitutional authority to tax income could probably be used to authorize a tax on the yield from intangibles. However, a constitutional amendment mandating the tax might be preferable so that the tax would be firmly established. This would be especially important once intangibles were exempted from the ad valorem property tax.

### CONCLUSIONS

Should intangibles be taxed? Many people think they should not be subject to any tax. For example, one economist writes:

Property taxation of intangibles is thus open to condemnation on the counts of both theory and practice. Intangibles do not constitute a separate ability to pay nor do they derive significant benefits separate from those accruing to the wealth which they represent. Clearly there are no theoretical grounds upon which their taxation can be justified.

But the opinion on his point is sharply divided. A different author states the case in favor of taxing intangibles in this way:

Intangibles taxation will massively reverse the growing tendency to shrink the property tax base for special interest groups who can persuade defensive state legislatures that one property tax loophole deserves another. . . . It would recognize that wealth is still some measure of ability to pay and that intangible property and its owners as well as real property and its owners benefit from ordered government.

The Legislature may soon have to choose between these two views.

#### APPENDIX

As mentioned on page 3, applying the property tax to intangibles should have the effect of reducing the amount of federal income taxes paid by Texas residents. This would happen because the owners of intangible assets will be able to receive large federal tax deductions if they have to pay property taxes on the intangibles.

An example should help to clarify this. Consider two residents of a tax district:

- Mr. X earns a salary of \$8,000 a year, which puts him in the 20% federal tax bracket. He owns a house with a market value of \$40,000.

- Ms. Y earns a salary of \$42,000 a year, which puts her in the 50% federal tax bracket. She owns corporate bonds worth \$40,000 but owns no real property.

If the district's effective property tax rate is 1% of market value, Mr. X currently pays \$400 (or 1% of \$40,000) in property taxes on his house. He is able to deduct these taxes on his federal income tax return, saving him \$80 (or 20% of \$400) in income taxes. Ms. Y now pays no property taxes, and therefore is not entitled to any tax deduction.

Suppose that half of the property in the tax district is real property now subject to the ad valorem tax. The other half is intangible property not previously taxed. If the district begins to tax intangibles on the same basis as real property, the tax base will double, allowing the tax rate to fall from 1% of market value to 0.5%.

Mr. X will then pay only \$200 (or 0.5% of \$40,000) in property taxes. His federal tax deduction will also be cut in half, so his savings will be only \$40. But now Ms. Y will have to pay property taxes on her bonds. Her tax will also be \$200 (0.5% of the bonds' \$40,000). She will be able to deduct this tax on her federal tax return. Since she is in the 50% bracket, the deduction will save her \$100 (or 50% of the \$200 property tax payment) in income taxes.

The income tax deductions can be thought of as a federal government "contribution" towards the local property taxes. This federal share when only real property was taxed was the \$80 that Mr. X saved on his income tax. When intangibles were added to the tax rolls the federal share jumped to \$140 (\$40 via Mr. X and \$100 via Ms. Y). The table on the following page summarizes this example.

	<u>Existing situation with tax on real property only</u>	<u>New situation with tax on intangibles added</u>
Property tax payments		
Mr. X	\$400	\$200
Ms. Y	0	200
Total	\$400	\$400
Savings on federal income tax paid:		
Mr. X	\$80 (=20% of \$400)	\$ 40 (=20% of \$200)
Ms. Y	0	100 (=50% of \$200)
Total	\$80	\$140
Net contribution to local tax district:		
Mr. X	\$320 (= \$400 - \$80)	\$160 (= \$200 - \$40)
Ms. Y	0	100 (= \$200 - \$100)
Federal government	80	140
Total	\$400	\$400

Mr. X (the middle-income taxpayer) saves half of his original net tax payment, or \$160. Ms. Y (the upper-income taxpayer) previously paid no property taxes, but now pays a net amount of \$100. And the federal "contribution" to local property tax revenues rises from \$80 to \$140. The higher the income of the people who own intangibles, the greater will be the added federal contribution to local government revenues.

Several things should be noted about this example. First, it is not likely that enough intangibles would be added to the tax base to reduce the tax rate by half. Second, this calculation would be altered if Congress makes any changes in the rules for deductibility of local

taxes on federal income tax returns. And finally, the example shows that even with the addition of intangibles to the tax rolls the property tax would still "cost" the higher-income person less (\$100 compared to \$160 for the middle-income person) for a given amount of property once federal tax savings were taken into account. So the taxation of intangibles would make the property tax less regressive but would not turn it into a progressive tax.

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D. BRODY

**APPENDIX F**

UNITED STATES DISTRICT COURT  
WESTERN DISTRICT OF TEXAS  
AUSTIN DIVISION

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CIVIL ACTION NO. A-76-CA-223

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LESLIE C. WILSON, et al.

v.

M. L. BROCKETTE, COMMISSIONER OF  
EDUCATION OF THE STATE OF TEXAS

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CIVIL ACTION NO. A-77-CA-21

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N. T. BENNETT, et al.

v.

M. L. BROCKETTE, COMMISSIONER OF  
EDUCATION OF THE STATE OF TEXAS

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(Filed July 18, 1977)

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**ORDER**

Came on this day for consideration by the Court the above styled causes. The Court, having carefully considered the Plaintiffs' applications for preliminary injunction, the evidence and oral argument adduced at the

hearing on the applications for preliminary injunction, the brief in support of the applications and all the other papers on file in these cases, is of the opinion that the applications for preliminary injunction should be denied.

These cases challenge the constitutionality of the provisions of the *Texas Education Code* that set up the scheme for allocating state funds to local school districts, alleging that the system for determining what amount of state funds will be allocated to each local school district violates the federal Equal Protection Clause and TEX. CONST. art. VIII, § 1 and statutes implementing art. VIII, § 1. Plaintiffs seek a preliminary injunction to insure that there will be adequate funds available to redress any injury that they have suffered in the event that they are successful on the merits. Defendant denies that any such injunction is warranted under the facts in these cases.

In order to be entitled to preliminary injunctive relief, a plaintiff must meet "the high threshold burden of proving, '(1) a substantial likelihood that [he] will prevail on the merits, (2) a substantial threat that [he] will suffer irreparable injury if the injunction is not granted, (3) that the threatened injury to [him] outweighs the threatened harm the injunction may do to the defendant, and (4) that granting the preliminary injunction will not disserve the public interest.' " *Hillsboro News Company v. City of Tampa*, 544 F.2d 860, 861 (5th Cir. 1977). The Court will address each of these requirements separately as they relate to the final form of preliminary injunctive relief that was requested by Plaintiffs at the hearing on their application for preliminary injunction (i.e. that the Defendant be required to keep sufficient money in reserve to allow him to pay Plaintiffs any money

to which they might be entitled as a result of the outcome of these cases).

The first element that a plaintiff must prove in order to be entitled to a preliminary injunction is that he has a substantial likelihood of prevailing on the merits. In the instant case, this means that the Plaintiffs must demonstrate that they have a substantial likelihood of prevailing on either their federal constitutional claim or the pendent state law claim. The gist of Plaintiffs' federal equal protection claim is that the Defendant's formula for distributing state funds to local school districts irrationally classifies school districts' abilities to raise local tax money to support public schools according to the value of real estate and automobiles within the districts, failing to take into account other tangible personality and all intangible personality, which is taxable under Texas law. The gist of Plaintiffs' pendent state law claim is that Defendant has adopted a system for determining how much taxable property is located in each local school district (the "Official Compilation") that does not include all of the property that is made taxable by the Texas Constitution and statutes, and thus, the system is illegal under Texas law.

The evidence adduced at the hearing on the applications for preliminary injunction shows that it is almost uncontested that the "Official Compilation" does not actually reflect the true value of all taxable property in each school district in that it fails to take into account the value of most tangible personal property, except automobiles, and the value of most, if not all, intangible personal property. Likewise, the evidence adduced at the hearing shows that it is almost uncontested that the

effect of this defect in the "Official Compilation" is not evenly distributed among all school districts. Specifically, the "Official Compilation" presents a much more accurate picture of the total taxable property in rural areas (where a higher percentage of all taxable property in real estate as opposed to personality) than it does in urban areas (where personality constitutes a higher percentage of all taxable property than is the case in rural areas).

The result of this disparity in the "Official Compilation," when the figures are used in the statutory formula to determine how much state aid will be given to each school district, is to require that rural school districts raise a much larger proportion of the costs of operating their schools (through local school taxes) than is required of urban school districts, when compared to their tax base, and consequently, rural school districts receive a smaller proportion of state aid, in comparison to their relative tax bases, than do urban school districts. In sum, school districts with the same amount of taxable property, but distributed differently as between realty and personality, are treated differently in the distribution of state funds to support public education.

This system of distributing state funds to support public education violates the federal Equal Protection Clause. The Court is well aware of the fact that legislatures have broad discretion and power to classify in the field of taxation, *see San Antonio Independent School District v. Rodriguez*, 411 U.S. 1, 40-41 (1972), but this does not mean that a state's taxing and disbursing decisions are immune from federal constitutional scrutiny. *See Levy v. Parker*, 346 F. Supp. 897 (E.D. La. 1972) (three judge court), *aff'd mem.*, 411 U.S. 978 (1973).

There is no constitutional infirmity in the Defendant distributing state funds to local school districts on the basis of their equalized ability to raise local funds, as determined by the total amount of taxable property in each school district, but the Defendant may not constitutionally distribute state funds to local school districts on the basis of the amount of certain classes of taxable property in each district, while ignoring other classes of taxable property in each school district, without any rational basis for so discriminating between different types of taxable property. The Defendant's current system of distributing state aid to local school districts treats local school districts (and their taxpayers) with the same amount of taxable property differently, without any rational basis, thus violating the federal Equal Protection Clause.

Likewise, the current system of distributing state funds for education to local school districts violates the applicable provisions of state law. TEX. CONST. art. VIII, § 1 provides that "Taxation shall be equal and uniform. All property in this State, . . . shall be taxed in proportion to its value. . . ." TEX. REV. CIV. STAT. ANN. art. 7145 provides that "All property, real, personal or mixed, . . . is subject to taxation. . . ." TEX. REV. CIV. STAT. ANN. art. 7147, which defines personal property, makes it clear that all personal property, both tangible and intangible, is subject to taxation. In interpreting the Texas requirement that all property be taxed, the Texas Supreme Court has stated:

The deliberate adoption of a plan for the omission from the tax rolls of a large volume of property, personal or real, is in direct contravention of con-

stitutional and statutory provisions for equality and uniformity of taxation. Article VIII, Section 1, Constitution of Texas, Vernon's Ann. St.; Article 7147, Vernon's Annotated Civil Statutes, 1925. Such a plan of taxation results in the rankest kind of discrimination between taxpayers. It does not lie with local taxing authorities to say that certain classes shall bear the entire burden of ad valorem taxes.

*City of Arlington v. Cannon*, 271 S.W.2d 414, 416 (Tex. 1954). The above authority makes it clear that State officials are not at liberty to choose what is to be considered taxable property and what should be excluded from that classification. The clear implication is that whenever public officials take any actions regarding taxable property they must consider all of the property that is made taxable by state law, and not just that which seems best to them. Thus, Defendant cannot devise a formula for the distribution of state aid to local school districts based on certain classes of taxable property. In fact, TEX. EDUC. CODE ANN. § 16.252(a) provides that the formula for distributing state aid to local school districts is to be based on the "total taxable value of property in the district." Thus, the formulation of an "Official Compilation" that includes only the values for certain classes of property contravenes the provisions of the *Texas Education Code* that provides that the distribution formula is to be based on the total value of taxable property in each school district. The Defendant's distribution of state aid to local school districts by means of the values in the "Official Compilation" violates state law. Therefore, Plaintiffs have carried their burden of proving a substantial likelihood of success on the merits of both their federal constitutional claim and their pending state law claim.

The second element that a plaintiff must prove in order to be entitled to a preliminary injunction is that there is a substantial threat that he will suffer irreparable injury if the injunction is not granted. The preliminary injunctive relief sought by Plaintiffs is to insure that there will be adequate funds available to redress any injury to the Plaintiffs if they are successful on the merits of the cases. Since the Defendant is a state official and any funds would necessarily have to come from the state, Plaintiff's requests for injunctive relief might raise a substantial Eleventh Amendment problem were it not for the fact that the Defendant has assured the Court that he would pay any funds due to the Plaintiffs if they are successful on the merits and that funds will be available without the need of specifically having the funds set aside by Court order. Although this assurance vitiates the Eleventh Amendment problem, it also establishes that Plaintiffs will suffer no irreparable injury even if the Court were to deny the requests for a preliminary injunction. All of the evidence adduced at the hearing establishes that there is no irreparable injury that will befall Plaintiffs if the preliminary injunction is denied.

The third element that a plaintiff must prove in order to be entitled to a preliminary injunction is that the threatened injury to him outweighs the threatened harm the injunction may do to the defendant. In the facts of these cases, Plaintiffs will not be harmed if the requests for preliminary injunction are denied and Defendant would not be harmed if they were granted, so that this element of the requisites for preliminary injunctive relief cancels itself out.

The final element that a plaintiff must prove in order to be entitled to a preliminary injunction is that granting a preliminary injunction will not disserve the public interest. Since the final form of Plaintiffs' requests for a preliminary injunction would not cause any interference with the payment of funds to other school districts under the challenged method of allocating state funds to local school districts, but rather only insure that money will be available to pay Plaintiffs what they claim would be owed them under a proper scheme of distribution, granting such an injunction would not disserve the public interest in any way. Nevertheless, a preliminary injunction cannot be granted, because the Plaintiffs have failed to establish that failure to grant a preliminary injunction would cause them any irreparable harm.

These are rather unusual cases in that Plaintiffs have established a very substantial probability of success on the merits in proving that the Defendant's actions have violated both the federal constitution and the state constitution and statutes, but nevertheless, Plaintiffs are not entitled to a preliminary injunction. It should be emphasized that this Court's denial of Plaintiffs' applications for preliminary injunction does not in any way indicate that they will not succeed on the merits or that they will not be entitled to a permanent injunction against the Defendant's conduct if they are successful on the merits. Plaintiffs' application for preliminary injunction are being denied solely because there is no evidence that a preliminary injunction is necessary in order to keep the Plaintiffs from being irreparably injured. Accordingly, it is

ORDERED, ADJUDGED and DECREED that Plaintiffs' applications for preliminary injunction should be, and hereby are, DENIED. This Order shall constitute findings of fact and conclusions of law.

Entered this 18th day of July, 1977, at Austin, Texas.

/s/ JACK ROBERTS  
Jack Roberts  
United States District Judge